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C O N F I D E N T I A L SECTION 01 OF 02 ASTANA 000737

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DEPT FOR EB/ESC; SCA/CEN (O'MARA)

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TAGS: ENRG EPET KZ
SUBJECT: TENGIZ UPDATE: RIOT DELAYS PRODUCTION INCREASE

REF: A. ASTANA 501

¶B. ALMATY 2273

Classified By: DCM Kevin Milas; Reasons 1.5(b) and (d).

¶1. (C) Summary: TengizChevrOil (TCO) General Director Todd Levy told DCM on November 27 that the October 20 riot at Kazakhstan's Tengiz oil field (Ref A) -- and the subsequent exodus of site workers -- would likely delay "second generation" Tengiz production from 4-6 months, until year-end ¶2007. Levy was more sanguine about TCO's ongoing dispute with the GOK about sulfur disposal, reporting that the GOK appeared satisfied with work being done on the subject by a recently-created Joint Task Force. Levy described how, following a request from President Nazarbayev to Chevron Chairman David O'Reilly, TCO had entered into negotiations to supply ethane (on "uneconomic terms") to a planned petrochemical plant near Atyrau. The negotiations, Levy predicted, would fail absent renewed high-level political pressure. TCO has identified several other promising oil and gas fields within its license area; however, with production "limited by surface facilities," development of these fields is unlikely until Tengiz is in decline. Levy's comments on TCO's oil transportation vision reported septel by Embassy Moscow. End summary.

Brawl Delays Second-Generation Production

¶2. (C) Astana DCM and Energy Officer, along with Moscow Energy Officer, called on Levy in Atyrau on November 27. Levy informed the DCM that the recent riot at Tengiz would likely delay the start-up of "second generation" Tengiz production "four to six months" from the target date of June 2006 (Ref B). (Note: the production increase, which will roughly double TCO's current output of 270,000 barrels/day, will occur in two stages, with an additional 100,000 b/d added in 2007, and another 130,000 b/d added in 2008. End note.) The brawl had not interrupted current production, Levy explained -- TCO would meet 98.5% of its targeted 2006 output. However, the construction project was suffering from the absence of workers who had left the site after the incident. (TCO Government Relations Director Anthony Palmeirim later specified that 1600 expatriate workers -- the vast majority Turks -- had left the site and had yet to return. On December 1, ExxonMobil's Government Relations Director, Patty Graham, told Energy Officer that a total of 4000 workers were absent, many of them Kazakhstani workers finding themselves without supervision.)

¶3. (C) Levy explained that, as a consequence of the incident and pressures from both the central and the oblast governments, TCO had doubled the minimum construction wage at

the site to roughly 54,000 tenge a year (USD 420). Levy noted that TCO was actively seeking to replace Turkish workers on site with those of other nationalities, "particularly Poles and Hungarians," as the site's Kazakhstani workers were more accepting of non-Turkish supervisors. TCO was also taking a general (and much-needed, Levy admitted) look at the overall living conditions at the contractor work camps. While the local akim would undoubtedly continue to get "political mileage" out of the incident, and made occasional threats about withholding low-skilled work permits, Levy was optimistic that the political aspects of the crisis were under control, leaving him to wrestle with the issue of labor supply.

¶4. (C) Note: On November 28, Richard Fritz of AGIP KCO (the Kashagan field operator), told DCM that AGIP had suffered labor unrest a few days after the Tengiz incident. Turkish workers had complained that they "felt threatened," he explained, and 3-4,000 Turkish workers had refused to report to work. In the end, he said, AGIP had managed to get the vast majority back to work, losing only 200 permanently. ExxonMobil's Graham worried about another consequence of the riot in a November 29 conversation, telling Energy Officers that the Ministry of Education had recently published a document in response to the riot which called on greatly increased private sector (read: oil company) financing of vocational education programs. The document, she said, would likely be a topic of conversation at the upcoming Foreign Investor Council meeting, where it would likely draw Nazarbayev's attention. End note.)

Sulfur Disposition On Track

¶5. (C) Levy told DCM that, notwithstanding the GOK's very

vocal late-summer criticism of TCO's sulfur stockpiles, the issue seemed to be under control. TCO had formed a Joint Task Force with various government ministries on the issue two months previous, he said, which seemed to have satisfied the GOK of TCO's intent to resolve the problem. TCO, Levy explained, was working through the Task Force to fund an environmental impact assessment, and to otherwise ground the discussion on the real (scientific) impact of the stored sulfur. Levy emphasized that TCO was continuing to meet its contractual obligations to dispose of sulfur -- in 2006, he said, TCO would likely sell 104% of the sulfur it produced, while working on a sales expansion project that would eventually raise that rate to 125%. Levy pointed out that, by the time the "Second Generation Production / Sour Gas Injection" project was completed, Tengiz alone would produce 15% of the world's supply of sulfur. Selling the newly-produced sulfur would be a daunting task in itself, he concluded, even without working to reduce the estimated 8 million tons of sulfur stored on site.

Petrochemicals -- With Political Pressure

¶6. (C) Asked about reports that TCO had agreed to supply 3 billion cubic meters (bcm) of gas annually to a planned petrochemical complex in Atyrau (to be built by "Kazakhstan Petrochemical Industries (KPI)" -- which, in turn, is owned by Basell, SAT & Co., and KMG E&P), Levy confirmed that negotiations were ongoing. Nazarbayev had "pressed" Chevron's Chairman "to be supportive" of the venture, Levy said, adding that "the only reason we are doing this is politics -- just to support the President."

¶7. (C) Levy explained that TCO and KPI had already agreed on a sales price, "$30-40 / thousand cubic meters," which was roughly half of what KPI would pay to draw gas from the nearby Central-Asia-Center pipeline. In the short-term, Levy said, KPI would sell the unused gas fractions (once the ethane and/or propane was extracted) on the market. However,

in the medium term TCO would need the gas for re-injection, and so would require KPI to "backfill" the volumes it received, purchasing additional gas on the open market, if necessary, to replace the extracted fractions. All of this, Levy concluded, meant that the project was probably "uneconomic." KPI would likely ask for a lower gas price and relief from the backfill obligations, he said, "but we're unlikely to reach agreement" -- unless the issues resolved at a political level; i.e., between Nazarbayev and Chevron Chairman David O'Reilly.

Other Promising Oil Fields

¶8. (C) DCM met separately with a team of TCO geologists, who reviewed the characteristics of eight additional "prospects" within the license area, including "Ansagan," which had excited Levy during conversation in June (Ref B). All of the prospects appeared to have between 200 million and 1 billion barrels of oil, "not enough to warrant the construction of stand-alone facilities." Tengiz production, in turn, was already limited by surface facilities ("and not by reservoir performance"), making it unlikely that the Tengiz facilities would be used to process oil from a new find. (Note: Oil from Korolev, a field 10 kilometers from Tengiz, is already being produced using Tengiz facilities.) Meanwhile, TCO was under pressure from regulators to either develop more fields or to allow other operators in the area. TCO is contractually obligated to relinquish percentages of its license area over time -- 50% by 2008, for example. While TCO was yet to relinquish acreage it thought was promising, the challenges of "managing the exploration license" would grow with time.
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